

## FY12 Budget Preview

### Broadening the Tax Base

## Economy and Strategy

The Government of Pakistan (GoP) is scheduled to announce the Fiscal Year 2012 budget on May 28, 2011, with an expected outlay of PKR 3,654bn. Given the weak FY11 fiscal stance as a starting point we view the GoP is unlikely to opt for an expansionary fiscal package ahead. Therefore, in order to stay affix with the prescribed budgetary brackets, we believe that the government will have to take extended measures to contain the fiscal deficit to 4.5% of GDP.

#### FY11 Fiscal performance presents a weak starting point ...

We view that the FY11 fiscal deficit is likely to surpass the government original target of 4.7% of the GDP. This is despite the fact that the government has undertaken austere measures by cutting federal expenditure majority of which comprised of PSDP. With real GDP growth being far lower than initially envisaged, the Ministry of Finance has revised FBR tax collection target down from PKR 1,667bn to PKR 1,588bn. However despite these initiatives, 9MFY11 fiscal performance has shown some worrisome factors. Overall tax collection stood at PKR 1,118bn showing a mere 10% YoY increase. The budget financing was led by mobilizing domestic sources which against the external sources (recorded a 10%YoY decline) grew by almost 31%YoY.

#### FY12 Budget Theme: Broadening the tax base

The FY12 budget will be focused more in expanding the tax base and pacing down if not curtailing down the overall expenditure growth. Financing the deficit will remain skewed towards domestic sources, mainly on the banking system subsequently crowding out private sector. On the positive front reform measures like removal of exemptions/zero ratings, broadening of tax base and gradual removal of subsidies are pointing in the right direction. Apart from the continuation of reform undertaken in the March 2011, few measures that the government is expected to undertake include raising corporate tax for banks from 35% to 37.5%, introduction of Gross-asset tax (GAT) and Imposition of 10% levy on natural gas.

#### Capital Market Measures and Outlook

The market this time around is likely to be lesser skeptical about direct tax related measures with the implementation of Capital Gain Tax (CGT) and removal of Capital Value Tax (CVT) in FY11 budget. However, the complexities and vague clauses in computation of CGT have created uncertainty for investors. The proposed step could help in improving trading volumes of the market, which have witnessed a decline of 41% YTD since implementation of CGT. Few proposals directly related to capital market include, removal WHT on sale value and FED on gross commission, exemptions for small investors, enhancing tax credit facility for IPOs, adjusting CGT against PKR depreciation for foreign investors, carry over of capital loss for six years.

#### Outlook

Based on proposed measures our stance on the capital market is Neutral. Our stance on the sectors is Neutral to Negative, considering proposals like GAT, enhance tax rate on banks and 10% Gas Levy. Our top picks are POL, PPL, APL, PSO, LOTPTA, HUBC, ENGRO, UBL, NBP.

Budget FY12 Outlay	FY11T	FY11E	FY12P
PKR bn			
Total Revenue	2,574	2,330	2,748
Tax Revenue	1,858	1,632	2,068
<b>Non-Tax</b>	716	698	680
Total Expenditure	3,259	3,392	3,654
Current Expenditure	2,519	2,877	2,764
PSDP	610	509	710
Budget Deficit	685	1,062	906

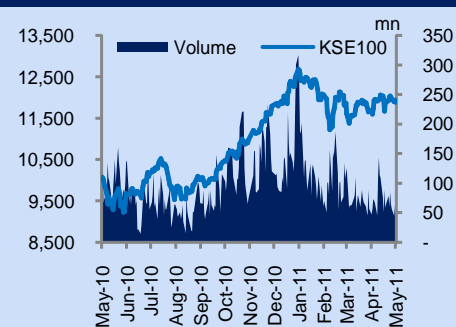
As % of GDP			
Total Revenue	15.2%	13.7%	13.7%
Total Expenditure	19.2%	19.9%	17.3%
Budget Deficit	4.7%	6.2%	4.5%

Source: Ministry Of Finance, AHL Research

Summary Data	FY10	FY11P	FY12B
GDP(PKRtrn) MP	14.67	17.06	19.21
Real GDP Growth	4.1%	2.1%	4.2%
Service Growth	4.6%	4.7%	5.1%
Industrial Growth	5.2%	4.7%	3.7%
Agricultural Growth	2.0%	3.7%	3.4%

Source: Ministry Of Finance, AHL Research

#### KSE100 Index Movement



Source: KSE

#### Analyst

**AHL Research**  
 research@arifhabilttd.com  
 021-32462589

[www.arifhabilttd.com](http://www.arifhabilttd.com)

## **FY11 Fiscal performance presents a weak starting point ...**

We view that the FY11 fiscal deficit is likely to surpass the government revised target of 4.7% of the GDP. This is despite the fact that the government has undertaken austere measures by cutting federal expenditure majority of which comprised of PSDP. With real GDP growth being far lower than initially envisaged, the Ministry of Finance has revised FBR tax collection target from PKR 1,667bn down to PKR 1,588bn. In order to achieve the revised target, the government has taken measures such as a 15% flood surcharge, increasing Special Excise Duty from 1% to 2.5%, removal of Sales Tax exemption on agricultural inputs and five major exports oriented sectors (Textile, Leather, Carpets, Sports and Surgical Goods).

However despite these initiatives, 9MFY11 fiscal performance has shown some worrisome factors. Overall tax collection stood at PKR 1,118bn showing a mere 10% YoY increase with Non-tax revenue registering a 2.5% decline, bringing the total revenue collection at PKR 1,495bn against PKR 1,402bn in the same period last year. Therefore in last quarter the government needs to raise additional PKR 741bn in order to meet the collection target.

Meanwhile total expenditure has somewhat been restrained at PKR 2,279bn against PKR 2,028bn in 9MFY10. This is led by high cost of defense expenditure and interest payments which historically have consumed almost 40% of the total current expenditure and continues to register it growth momentum of 24%YoY and 7%YoY respectively.

The overall financing was led by mobilizing domestic sources which against the external sources (recorded a 10%YoY decline) grew by almost 31%YoY in 9FY1. Going forward given the expected slow down in overall economy, we believe there exists a high risk of revenue shortfall and overall government spending is likely to exceed the original target, thus making it increasingly difficult for the government to stay fiscally on track in FY11. We preserve our initial stance of fiscal deficit likely to clock in at 6.2% of the total GDP.

### **...resulting in a no 'Pro-Growth' fiscal stimulus package**

Given the weak FY11 fiscal stance as a starting point we believe the GoP is unlikely to opt for an expansionary fiscal package ahead. Therefore in order to stay affix with the prescribed budgetary brackets we believe the government is expected to take extended measures to contain the fiscal deficit. The FY12 budget will be more focused in expanding the tax base and pacing down if not curtailing down the overall expenditure growth. While heavy reliance on domestic sources will keep exerting pressure on private sector credit. Hence reduction in government spending alongwith an overall weakening private sector disposable credit is likely to present a no 'Pro-Growth' fiscal budget ahead. Whereas pending fiscal reforms under the IMF program are likely to shore up.

## FY12 Budget - Fiscal tightening ahead...

The Government of Pakistan (GoP) is expected to announce the Fiscal Year 2012 budget on May 28, 2011. This would be the 4<sup>th</sup> budget presented by this government. Some proposed budgetary highlights are as under:

- Total budget outlay in FY12 is expected to jump by 12% YoY to PKR 3,654bn (17.3% of GDP) compared to revised FY11 target of PKR 3,259bn (19.2% of GDP).
- Total revenues are expected around PKR 2,748bn (13.7% of GDP) out of which FBR collection are likely to reach PKR 1,952bn, a 23% increase, compared with the revised collection figure of PKR 1,588bn in FY11.
- Current expenditures are projected at PKR 2,764bn (13.7% of GDP) for FY12, against PKR 2,519 (14.8% of GDP) in FY11.
- Allocations for Public Sector Development Program (PSDP) are expected around PKR 710bn in FY12, a 16% higher than the revised figure of PKR 610bn allocated in FY11.
- With these measures undertaken the fiscal deficit is estimated to clock in around PKR 906bn or 4.5% of the total GDP.

	FY10A	9MFY11	FY11(T)	FY11 (E)	PKRbn
					FY12(P)
<b>Total Revenue</b>	2,078	1,495	2,574	2,330	2,748
Tax Revenue	1,473	1,118	1,858	1,632	2,068
of which FBR	1,327		1,588	1,538	1,952
Non-Tax	605	378	716	698	680
<b>Total Expenditure</b>	3,007	2,279	3,259	3,392	3,654
Expenditure booked	2,904	2,263	3,129	3,386	3,474
Current Expenditure	2,386	1,910	2,519	2,877	2,764
of which Interest Payments	642	507	699		
Defense	375	335	442	554	495
Development Expenditure(PSDP)	518	353	610	509	710
<b>Budget Deficit</b>	929	783	685	1,062	906
Financing	929	783	685	1,062	
External	189	83	186	170	
Domestic	740	700	499	892	
<b>As a percentage of GDP</b>					
Total Revenue	14.20%	8.60%	15.20%	13.70%	13.70%
Total Expenditure	20.50%	13.20%	19.20%	19.90%	17.30%
Current Expenditure	16.30%	11.00%	14.80%	16.90%	
of Which Interest payments	4.40%	2.90%	4.10%	0.00%	
Defense	2.60%	1.90%	2.60%	3.30%	
PSDP	3.50%	2.00%	3.60%	3.00%	3.50%
<b>Budget Deficit % of GDP</b>	<b>6.30%</b>	<b>4.50%</b>	<b>4.70%</b>	<b>6.20%</b>	<b>4.50%</b>

Source: Ministry Of Finance, AHL Research

## Taxing the un-taxed economy

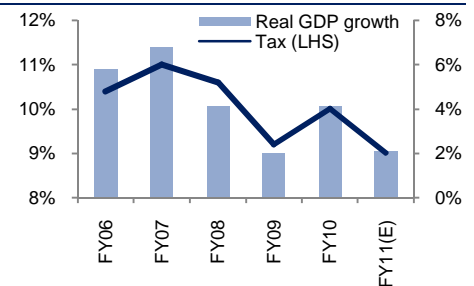
The proposed tax revenue targets for FY12 budget are set at PKR 2,068bn, 11.3% YoY higher than FY11 revised target of PKR 1,858bn. In order to achieve these targets the government is considering to implement the following measures:

- Removal of sales tax exemptions are already underway through the Presidential Ordinance, where by the government has brought sectors like agricultural inputs, textiles, carpets, leather, sports and surgical goods under the sales tax net.
- The GoP may either implement RGST @ 15% or consider withdrawal of sales tax exemption from a number of sectors. The question of implementing RGST stems mainly on fulfilling the condition imposed by the IMF in the release of the 6<sup>th</sup> tranche worth US\$1.7bn.
- FBR is aiming for increase in WHT on Service sector from 6% to 10%.
- Retail sector is likely to come under a 'fixed tax regime' based on different turnover slabs.
- Proposal to increase corporate tax of banks from 35% to 37.5%. In addition to this WHT on cash withdrawal above PKR 25,000 may likely go up from 0.3% to 0.5%.
- Gross Asset Tax (GAT) is unlikely to be implemented in the upcoming federal budget, as 18<sup>th</sup> Constitutional amendment has made tax on immovable property a provincial subject and will require their approval for implementation.
- Introduction of 10% levy on natural gas and reduction of gas subsidy on fertilizer feed stock is proposed.
- Proposal of 7-8% FED to be levied on sugar in order to bring the effective tax rate to 17%; at par with other commodities. This is likely to generate additional tax of PKR 24bn for the government.
- We believe the government is likely to go for listing and privatization for DISCOs and Public Sector Enterprises (PSEs), issuance of exchangeable bond for OGDC (US\$ 500mn) and secondary offering of Pakistan Petroleum Limited.

Along with this, the following taxation measures announced in March 2011 by a Presidential Ordinance will be passed by the parliament through Finance Act 2012:

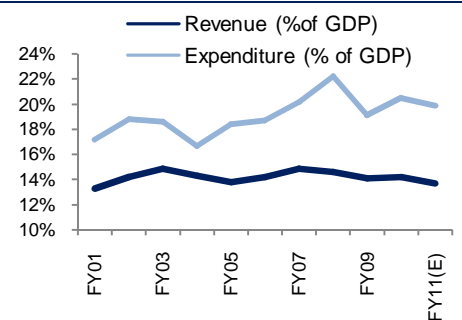
- Increase in special excise duty (SED) from 1% to 2.5%
- Withdrawal of Sales Tax exemption on agricultural inputs such as pesticides, fertilizers and tractors
- Removal of exemption and zero rating on five major exporting sectors namely Textile, Leather, Sports, Surgical Equipments and Carpets.

### Declining tax Revenue



Source: Ministry of Finance

### High expenditure to revenue as % of GDP



Source: Ministry of Finance

**Lowering expenditures means lowering subsidies...**

The government has taken fresh austere measures in cutting the non-development spending including public employee salaries and sharp cuts in Public development projects in FY11. This austerity is to exercised more vigorously in FY12 as the government will be facing higher spending on defense and debt servicing. Given the deteriorating law and order situation, defense budget is likely to go up by 10-15% YoY to PKR 495bn in FY12. In addition to this, repayments of the IMF SBA facility are scheduled to start in FY12, which is likely to increase debt servicing from FY12. Historically the defense and debt servicing expenditure constitutes almost 43% of the total current expenditure and its share allotment is likely to exceed in the upcoming FY12 budget.

In addition to this the consolidated figure for PSDP is being estimated at PKR 710bn against PKR 485bn in FY11, while total PSDP funds allotment for federal are likely to be capped at PKR 280bn up against PKR 180bn in FY11. Tracking the PSDP allocation record against actual disbursement is of a critical one. As for instance total budget allocation for PSDP in FY11 was PKR 610bn whereas actual disbursements are projected at PKR 485bn for FY11. Final disbursement of PSDP for FY12 will depend on external sources.

**Reducing subsidies is the way forward**

The government has proposed to withdraw subsidy on the fertilizer and power sector. The imposition of gas levy worth PKR35bn, reduction in gas subsidy and other measures could cumulatively reduce the subsidy amount by PKR100bn in FY12. Although the government is planning to provide power subsidy of approximately PKR 189bn in the upcoming budget; however rising power tariff would eventually phase out power subsidies going forward.

**Financing: mobilizing domestic sources...**

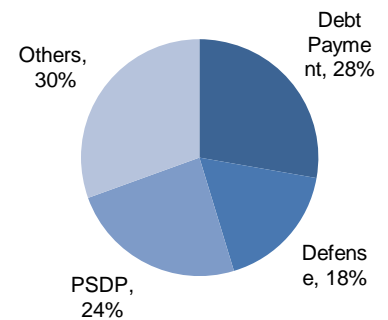
**Financing to remain skewed on domestic sources...**

Although foreign investments have showed below par performance, given the multitude of reasons. Plugging in the deficit gap alone, with reliance on domestic sources will be an uphill task for the government. Tracking the 9MFY11 performance, the total external financing stood at PKR 83bn, against full year budgeted target PKR 185.6bn. This subsequently has led to increased reliance on the banking sector, thus crowding out private credit.

**...but reforms to gather much needed attention from IMF**

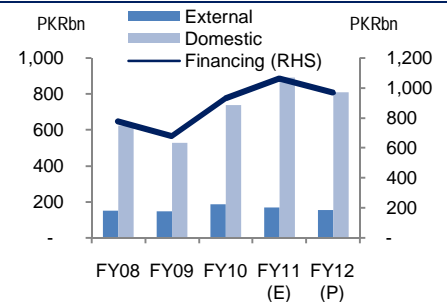
However given the reforms likely to be undertaken in the upcoming budget such as enhancing tax to GDP ratio, removal of subsidies in power sector and steps to implement reforms in sales tax, assures fiscal stability in FY12. This is likely to pave its way for the 6th tranche from IMF worth US\$ 1.7bn under the SBA program or least issuance of letter of comfort from IMF. This would be necessary in easing pressure over domestic financing.

**Share of current expenditure**



Source: Ministry of Finance

**Financing Resources**



Source: Ministry of Finance

## Economic targets

Given the fall out of floods in FY11, the government remains optimistic for an above par recovery in FY12.

- The government envisages a GDP growth of 4.2% in FY12 against 2.4% expected in FY11. Agricultural and manufacturing sectors are expected to show some modest recovery after being heavily affected by the floods in 2010.
- Headline inflation expectations are on the lower side at 12% YoY on average against 14.5-15.5% YoY projected in FY11. Low inflationary expectation is likely to make its way to monetary easing.
- Exports are expected to register a modest growth of 4% at US\$ 25bn, which may lower the trade deficit to US\$ 13.2bn in FY12 against estimated US\$ 13.77bn.
- Remittances are expected to remain strong crossing US\$ 12bn mark.

## Macroeconomic Indicators and Forecasts

	FY08	FY09	FY10	FY11E	FY12B
<b>Real</b>					
Real GDP Growth	3.7%	1.2%	4.1%	2.1%	4.2%
GDP(PKRbn) MP	9,922	12,739	14,668	17,064	19,209
Service sector growth rate FC	6.0%	1.6%	4.6%	4.7%	5.1%
Industrial sector growth FC	4.8%	-3.7%	5.2%	4.7%	3.7%
Agricultural sector growth FC	1.0%	4.0%	2.0%	3.7%	3.4%
<b>Prices</b>					
CPI(YoY)	12.0%	20.8%	11.7%	15.8%	12.0%
M2 Growth	15.4%	9.6%	12.5%	13.8%	12.8%
Policy rate (end rate)	12.0%	13.5%	13.9%	15.0%	13.5%
6-month KIBOR(end Period)	14.0%	12.7%	12.3%	13.4%	13.2%
<b>External Sector</b>					
Exports(US\$bn) FOB	20.4	19.1	19.6	22.38	25.9
Imports(US\$bn) FOB	35.4	31.7	31.1	36.14	39.1
Trade Deficit(US\$bn)	(15.0)	(12.6)	(11.4)	(13.77)	(13.20)
Remittances(US\$bn)	6.5	7.8	8.9	10.2	12
FDI(US\$bn)	5.4	3.7	2.2	2.4	3.1
Fx Reserves (US\$bn)	8.6	9.1	13.0	17.3	17.8
Exchange Rate	68.2	81.3	85.3	85.2	91.5
CAB (US\$bn)	(13.9)	(9.3)	(3.5)	(4.14)	(3.70)
<b>Public Finances</b>					
Total Revenue(PKRTTrn)	1.40	1.70	2.00	2.06	2.07
Tax Revenue(PKRtrn)	1.00	1.20	1.50	1.46	1.95
Expenditure (PKRtrn)	1.90	2.10	2.50	3.12	3.02
Total Tax Revenue(%GDP)*	9.9%	9.8%	10.1%	8.6%	9.7%
Expenditure (%of GDP)*	17.3%	14.8%	15.9%	18.3%	15.0%
Consolidated Deficit	22.9%	19.9%	20.5%	6.2%	4.5%
Total Public Debt (PKRbn)	6,044	7,629	8,894	9,473	
Public Debt (% of GDP)	59.0	59.9	60.6	55.1	

Source: SBP, Finance Ministry, AHL Research

## Gross Asset Tax (GAT) a new tax in the making

The government is considering to impose GAT of 1% or 1.25% in the FY12 budget. The GAT is to be levied on company's gross assets. However, the impediment could arise in imposing this tax as with the passing of 18th amendment right to tax immovable property has been transferred to provinces. If imposed at 1% it would result an average 7.4% dilution in the earnings of our universe. We have based our calculation of GAT on fixed assets of the companies.

						PKRmn
Symbol	Outst . Shares	Fixed Assets (31 Mar, 2011)	GAT @ 1%	% impact	GAT @ 1.25%	% impact
<b>E&amp;P</b>						
PPL	1,195	43,540	435	1.2%	544	1.5%
POL	237	3,939	39	0.3%	49	0.4%
OGDC	4,301	37,486	375	0.5%	469	0.6%
<b>Banks</b>						
NBP	1,682	27,353	274	1.5%	342	1.9%
UBL	1,224	22,513	225	1.7%	281	2.1%
BAFL	1,349	14,102	141	5.9%	176	7.3%
MCB	836	21,404	214	1.1%	268	1.3%
<b>Fertilizer</b>						
ENGRO	393	133,112	1,331	17.4%	1,664	21.7%
FFBL	934	14,485	145	2.4%	181	3.0%
FFC	848	15,406	154	1.1%	193	1.4%
<b>Cement</b>						
DGKC	438	23,407	234	17.9%	293	22.3%
LUCK	323	31,090	311	6.9%	389	8.6%
ACPL	87	5,062	51	5.5%	63	6.9%
<b>OMCs</b>						
PSO	172	5,899	59	0.6%	74	0.7%
APL	69	1,275	13	0.3%	16	0.4%
<b>Autos</b>						
INDU	79	4,071	41	1.7%	51	2.2%
PSMC	82	4,154	42	11.1%	52	13.9%
<b>Power</b>						
HUBC	1,157	50,503	505	7.0%	631	8.7%
KAPCO	880	17,250	173	2.6%	216	3.2%
<b>Textile</b>						
NML	352	13,010	130	3.3%	163	4.1%
<b>Chemical</b>						
LOTPTA	1,514	9,705	97	1.7%	121	2.1%
EPCL	663	19,002	190	73.4%	238	91.8%
<b>Fixed Line Telecom</b>						
PTC	5,100	87,102	871	5.7%	1,089	7.1%

## **Capital Market Measures and Outlook (Neutral)**

The market this time around is likely to be less skeptical about direct tax related measures with the implementation of Capital Gain Tax (CGT) and removal of Capital Value Tax (CVT) in FY11 budget. However, the complexities and vague clauses in computation of CGT have created uncertainty for investors. The proposed step could help in improving trading volumes of the market, which have witnessed a decline of 41% YTD since implementation of CGT. Few proposals directly related to capital market include:

- Removal of WHT on sales value and FED of 16% on gross commissions.
- Small investors, with an investment below PKR 10mn, be facilitated by an amnesty scheme allowing them to revise their last 5 years returns at a lower rate and to be exempted from filling return for CGT.
- Computation of CGT on transaction and its subsequent deduction by NCCPL. This should be considered as full and final discharge of liability in case of small investors.
- Carry forward of capital loss be allowed for six years from current one year.
- Loss disallowed incase of Wash Sale, Cross Trades and Tax Swap Sales be added to the cost of new securities acquired. Moreover, holding period of new securities to also include period older securities were held for.
- Trading of Debt securities through BATs to be exempted from CGT.
- Enhancing tax credit facility from 5% to free float based criteria or all IPO to be exempt from any capital market related taxes for 5 years from listing.
- Non-residents CGT computation should incorporate depreciation of PKR against respective currency.

### **Impact on Capital market of Tax related measures and sector proposals**

- The GoP is likely to push for RGST in the upcoming budget, which subsequently will result in rate being reduced from 17% to 15%. However, if RGST is not implemented, rate will remain at the same level.
- GAT is unlikely to be implemented in the upcoming federal budget, as 18<sup>th</sup> Constitutional amendment has made tax on immovable property a provincial subject and will require their approval for implementation.
- If corporate tax rate on banking companies is raised by 2.5% it would contract the sector's earnings by approximately 3.5%.
- Flood tax of 15% on tax liability imposed for 3.5 months (March 15, 2011 – June 30, 2011) is not likely to be extended beyond the timeline.

Based on proposed measures our stance on the capital market is Neutral. Our stance on the sectors is Neutral to Negative, considering proposals like GAT, enhance tax rate on banks and 10% Gas Levy. Our top picks are POL, PPL, APL, PSO, LOTPTA, HUBC, ENGRO, UBL, NBP.

## Banks (Neutral to Negative)

### Enhancing tax rate from 35% to 37.5% and WHT on cash withdrawals to 0.5%

FBR is pushing for increase in tax rate for banks by 2.5% to 37.5%. However, this is being opposed by State Bank of Pakistan. According to FBR, tax rate on the banks are being levied at a higher rate. This is being justified as banks are enjoying higher spreads compared to regional countries. If implemented our banking universe earnings could decline approximately by 3.5%. FBR is also pushing for increase in WHT on cash withdrawals from 0.3% to 0.5%

### Change in rules for allowance of NPL provisioning

FBR has proposed to change NPL for recognition of provisioning for tax purpose. Currently, provisioning of 1% on advances towards corporate sector and 5% on consumer and SME loans is allowed. According to reports, FBR is proposing to alter the rule to 1% of advances or 5% of total income before deduction of provisions whichever is lower. This is being done after evaluating regional practices.

### Impact—Negative

The above mentioned measure will be negative for the banking companies. Though, suggested change in NPL rules will result in higher differential between accounting tax and the tax payable. It will not effect reporting since banks' follow SBP laid down specified rules and procedures for NPL provisioning.

Symbol	Closing Price	Target Price	Upside/Downside	Stance	EPS		DPS		P/E	Div. Yield	ROE	P/B
					FY11	FY12	FY11	FY12	FY11	FY11	FY11	FY11
NBP	51.2	65.0	27%	Buy	10.69	12.58	7.00	7.50	4.78	13.7%	14.4%	0.63
UBL	63.6	72.5	14%	Buy	11.03	12.30	3.00	3.50	5.77	4.7%	18.6%	1.01
BAFL	10.4	11.6	12%	Buy	1.78	2.39	0.50	0.75	5.84	4.8%	10.1%	0.56
MCB	205.1	217.0	6%	Hold	23.87	25.53	10.00	10.00	8.59	4.9%	23.0%	1.93

Source: AHL Research

## Fertilizer (Neutral)

### 10% levy on Gas

GoP is considering to impose a levy of 10% on gas consumption by all the sectors including fertilizer. As per estimates this levy will generate PKR 50bn revenue for the government including PKR 6.8bn from the fertilizer sector.

### Removal of feed stock subsidy till FY13

Reduction in feedstock subsidy for fertilizer sector is on the cards. Currently, differential between feed and fuel stock stands at PKR 280/mmbtu. The GoP has already imposed GST of 17% on the fertilizer products after withdrawing exemption, effective from March 2011. The government may remove sales tax exemption on packaged milk, which would subsequently result in higher retail prices of the product. This could effect demand for the packaged milk, hence Engro's food business.

### Impact

With imposition of this levy, fertilizer companies are likely to pass the incremental impact to consumers by increasing the prices of the products. The sector has already increased the prices by PKR 140/bag after imposition of 17% GST. Moreover, GoP's intention to remove feedstock subsidy will subsequently increase the fertilizer prices, bringing them at par with international prices. We believe GoP will keep wheat support price at PKR 950/bag.

Symbol	Closing Price	Target Price	Upside/Downside	Stance	EPS		DPS		P/E	Div. Yield	ROE	P/B
					CY11	CFY12	CY11	CY12	CY11	CY11	CY11	CY11
ENGRO	192.3	224.0	16%	Buy	19.50	27.50	6.00	8.00	9.86	3.1%	18.9%	1.94
FFBL	41.5	42.2	2%	Hold	6.55	5.65	6.00	5.00	6.34	14.5%	54.9%	3.49
FFC	143.0	144.0	1%	Hold	16.20	17.38	15.50	16.50	8.83	10.8%	70.1%	5.73

Source: AHL Research

## Power Sector

**(Neutral)**

### Guaranteed supply for Industrial consumer

Government plans to introduce new “guaranteed and uninterrupted” power supply mechanism mainly for industrial consumers who are willing to pay higher for guaranteed and uninterrupted power supply.

### Energy sector strategy and monthly rise power tariff

Ministry of finance has proposed a 10-point energy sector conservation and revenue generation plan to be a part of budget 2011-12. Going forward implementation of this plan will help in resolving the circular debt issue. Moreover, plans are in place to increase power tariffs by 12% in the next fiscal year. The government has recently increased power tariff by 2%. With this hike in tariff the total increase in power tariff has reached to 19% YTD.

### Power subsidy to be extended for another year

The government has decided to extend subsidy on power tariff for another year. The total power subsidy amount projected by the GoP for the next fiscal is PKR 239bn as against of PKR 240bn in FY11. This projected subsidy amount also contains PKR50bn for tariff differential. Government plans to abolish power subsidy through gradual increase in power tariff and structural reforms by FY13.

### Impact

Since IPPs are governed under the power purchase agreement these measure will not have any impact on the companies. The GoP plans to list distribution companies (DISCOs) on the stock exchange.

Symbol	Closing Price	Target Price	Upside/Downside	Stance	EPS		DPS		P/E	Div. Yield	ROE	P/B
					FY11	FY12	FY11	FY12	FY11	FY11	FY11	FY11
HUBC	37.0	50.0	35%	Buy	5.03	6.26	5.00	5.90	7.35	13.5%	18.8%	1.42
KAPCO	42.8	51.4	20%	Buy	7.53	7.68	6.50	7.10	5.68	15.2%	28.3%	1.61

Source: AHL Research

## Exploration and Production (E&P)

**(Neutral)**

Oil and Gas Exploration and Production companies are governed by the petroleum polices. Thus budget is expected to be a non-event for the E&P sector. However, the upcoming federal budget will reveal dividend estimates of the Government from the two largest state-run E&P companies. We expect the Government to set FY12 target dividend of PKR 8/share and PKR 16/share from OGDC and PPL, respectively. Last year the Government had set the target of PKR 7.8/share for OGDC and PKR 8.3/share for PPL.

Symbol	Closing Price	Target Price	Upside/Downside	Stance	EPS		DPS		P/E	Div. Yield	ROE	P/B
					FY11	FY12	FY11	FY12	FY11	FY11	FY11	FY11
PPL	204.0	254.9	25%	Buy	28.19	30.32	15.00	16.00	7.24	7.4%	80.3%	2.54
POL	325.1	359.0	10%	Hold	45.94	49.33	30.00	30.00	7.08	9.2%	35.0%	2.24
OGDC	147.5	143.2	-3%	Sell	17.30	17.40	7.00	8.00	8.52	4.7%	55.0%	2.68

Source: AHL Research

## Cement

**(Neutral)**

### Yet another over ambitious PSDP target on the card

Annual Plan Co-ordination Committee has recommended the Public Sector Development Program (PSDP) of PKR 710bn for FY12. Although this looks overwhelming, but in last few years the government has not been able to translate it's over ambitious PSDP figure into actual spending. In FY11 budget, the government had allocated PKR 610bn for PSDP, which was later reduced to PKR 485bn; actual spending however remains far below. Given the tight fiscal situation of the government, we do not see much excitement for cement manufacturers in the PSDP of FY12; however reconstruction activities in the flood affected areas and strong farm income, which has led to unprecedented demand from the rural economy, would likely to play a major role in shaping the domestic cement demand going forward.

### Reduction in import duty on used Tyres is sort

Due to rising utilization of used tyres as a substitute fuel for coal, the cement industry is looking for a reduction in import duty on it, which currently stands at 25%. The government had imposed this duty to protect the local tyre industry, as new tyres were being import in the name of used tyres. Cement manufacturers may encounter a strong opposition from the tyre manufacturers, which can be somewhat diluted if cement industry demand abolishment of import duty on the shredded tyres.

### Levy on natural gas to raise production cost by 0.8-1.1%

If government decides to impose a 10% levy on the natural gas, then production cost of Lucky Cement and D.G. Khan Cement is likely to jump by 1.1% and 0.8%, respectively. However this impact can be easily passed through by raising cement prices; thus we find the impact of this levy immaterial for cement industry

### FED to remain unchanged

Cement industry is demanding a further cut in the federal excise duty, which was slashed by PKR 200/ton in the last federal budget. FED currently stands at PKR 700/ton (PKR 35/bag). We do not expect the government to further reduce the excise duty on cement sales.

Symbol	Closing Price	Target Price	Upside/Downside	Stance	EPS		DPS		P/E	Div. Yield	ROE	P/B
					FY11	FY12	FY11	FY12	FY11	FY11	FY11	FY11
DGKC	21.5	30.1	40%	Buy	1.72	2.99	-	0.75	12.48	0.0%	2.7%	0.27
LUCK	69.8	97.7	40%	Buy	11.86	13.92	5.00	6.00	5.89	7.2%	14.5%	0.83
ACPL	52.5	69.0	31%	Buy	7.39	10.55	5.00	5.50	7.10	9.5%	11.4%	0.74

Source: AHL Research

## Oil Marketing Companies

**(Neutral)**

### Petroleum Levy to yield PKR 110bn for the government

The government is likely to generate PKR 110bn in FY12 through Petroleum Levy (PL) given levies are brought to their original levels. The government was aspiring to collect PL of PKR 110bn in FY11 budget, however due to cut in PL since January 2011, the government is likely to receive PKR 90bn under this head. Thus PL collection is heavily dependent on the political sentiments if international oil price remain upwards sticky.

### Levy on gas will narrow the gap between price of CNG and MS

The government is contemplating to impose a 10% levy on the natural gas, which will narrow the pricing gas between Compressed Natural Gas (CNG) and Motor Gasoline (MS). This coupled with gas shortages particularly in the northern part of the country is increasing the demand of MS, which has already witnessing a strong recovery of 17.6% in FY11 YTD.

### Subsidies on power sector are likely to continue

Recent injection of PKR 120bn by the government has breathed some life in the energy chain. However long term solution lies with the increasing efficiency of DISCOs and plugging the gap between power generation cost and power billed. It is important to note that the government is planning to allocate PKR 239bn for power subsidies in FY12, which may resurrect the problem of circular debt. However the government's decision to increase the power tariff by 12% in FY12 may improve the liquidity of power sector going forward.

Symbol	Closing Price	Target Price	Upside/Downside	Stance	EPS		DPS		P/E	Div. Yield	ROE	P/B
					FY11	FY12	FY11	FY12	FY11	FY11	FY11	FY11
PSO	279.5	381.5	36%	Buy	77.74	60.03	15.00	20.00	3.60	5.4%	33.2%	7.23
APL	373.4	430.7	15%	Buy	57.20	58.90	35.00	40.00	6.53	9.4%	39.1%	1.95

Source: AHL Research

## Chemicals

**(Neutral)**

### LOTPTA, looking for an increase in PTA import duty

Lotte Group and KP Chemicals, the parent company of Lotte Pakistan PTA Limited (LOTPTA) is in discussion with the government to increase the import duty on Pure Terephthalic Acid (PTA). In July 2010, the government withdrew PTA duty monetization and reduced the import duty from 7.5% to 3%. Lotte Group is planning to invest US\$ 400-500mn in a new PTA plant with a capacity of 0.8-1.0mn tons, for which Lotte Group is seeking incentives for bringing new investment in Pakistan. We fear that the government may not grant this duty increase as it will further add to the woes of the downstream textile sector. Absence of PTA monetization will make the case of Lott Group even weaker. At current PTA price, every 1% increase in PTA import duty would increase the profitability of LOTPTA by PKR 0.21/share.

Symbol	Closing Price	Target Price	Upside/Downside	Stance	EPS		DPS		P/E	Div. Yield	ROE	P/B
					CY11	CFY12	CY11	CY12	CY11	CY11	CY11	CY11
LOTPTA	14.8	18.1	22%	Buy	3.83	3.65	1.00	1.00	3.87	6.7%	47.9%	1.53

Source: AHL Research

## Auto Sector (Neutral to Negative)

### New Entrant Policy to be announced

New Entrant policy is expected to be finalized in upcoming budget. Under this policy new entrants will be allowed to import 100% Complete Knock Down (CKD) Kits at the reduced rate of 15% for a period of next five years as compared to 32.5% for existing assemblers.

### Proposal to reduce duties

The government is considering abolishing regulatory duty and scaling down Customs duty to 25% on various luxury goods, which include new and used cars and their components. While Depreciation allowance of 1% per month on import of CBUs to remain unchanged, despite a proposal of 2% per month by the car importers.

Symbol	Closing Price	Target Price	Upside/Downside	Stance	EPS		DPS		P/E	Div. Yield	ROE	P/B
					FY11	FY12	FY11	FY12	FY11	FY11	FY11	FY11
INDU	220.0	242.0	10%	Hold	27.36	29.66	10.00	10.00	8.04	4.5%	15.6%	1.13
PSMC	67.8	67.3	-1%	Sell	4.54	5.99	2.00	2.00	14.94	2.9%	2.5%	0.35

Source: AHL Research

## Telecommunication Sector (Neutral)

Currently the telecom sector pays FED of 19.5%. In case, RGST is implemented, the sector will get a tax relief which can lead to ARPU improvement. In Mar 2011 Government increased the withholding tax on cellular services to 11.5% from 10%. We expect the tax will remain unchanged in budget 2011-12

Symbol	Closing Price	Target Price	Upside/Downside	Stance	EPS		DPS		P/E	Div. Yield	ROE	P/B
					FY11	FY12	FY11	FY12	FY11	FY11	FY11	FY11
PTC	16.6	24.7	49%	Buy	2.48	3.00	1.70	1.80	6.71	10.2%	11.3%	0.76

Source: AHL Research

## Textile Sector (Neutral)

GoP has already removed Zero-ratings and exemptions for textile manufacturers/exporters in the measure announced in March 2011. The textile sector will be charged GST at a rate of 4%-6% on local supplies. Since this was implemented through Presidential Order, this is likely to be part of finance act so it is approved by the parliament

## Disclaimer and related information

### Analyst certification

The analysts for this report certify that all of the views expressed in this report accurately reflect their personal views about the subject companies and their securities, and no part of the analysts' compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

### Disclosures and disclaimer

This document has been prepared by investment analyst at Arif Habib Limited (AHL). AHL investment analysts occasionally provide research input to the company's Corporate Finance and Advisory Department.

This document does not constitute an offer or solicitation for the purchase or sale of any security. This publication is intended only for distribution to current and potential clients of the Company who are assumed to be reasonably sophisticated investors that understand the risks involved in investing in equity securities.

The information contained herein is based upon publicly available data and sources believed to be reliable. While every care was taken to ensure accuracy and objectivity, AHL does not represent that it is accurate or complete and it should not be relied on as such. In particular, the report takes no account of the investment objectives, financial situation and particular needs of investors. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. AHL reserves the right to make modifications and alterations to this statement as may be required from time to time. However, AHL is under no obligation to update or keep the information current. AHL is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries.

Past performance is not necessarily a guide to future performance. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for any investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his or her own advisors to determine the merits and risks of such investment. AHL or any of its affiliates shall not be in any way responsible for any loss or damage that may be arise to any person from any inadvertent error in the information contained in this report.

We and our affiliates, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, company (is) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as advisor to such company (is) or have other potential conflict or interest with respect to any recommendation and related information and opinions. The disclosures of interest statements incorporated in this document are provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. AHL generally prohibits it analysis, persons reporting to analysts and their family members from maintaining a financial interest in the securities that the analyst covers.

<b>Contact information</b>			
<b>Equities Research</b>		<b>Email</b>	<b>Telephone</b>
Faisal Khan	Deputy Head of Research	faisal.khan@arifhabibltd.com	+92-21-3246-0742
Shahbaz Ashraf	Research Analyst	shahbaz.ashraf@arifhabibltd.com	+92-2132460717-19 Ext : 211
Syed Abid Ali	Research Analyst	abid.ali@arifhabibltd.com	+92-2132460717-19 Ext : 211
Saad Khan	Economist	saad.khan@arifhabibltd.com	+92-2132460717-19 Ext : 248
Usman Saeed	Research Analyst	usman.saeed@arifhabibltd.com	+92-2132460717-19 Ext: 248
Khurram Kamal	Database Officer	khurram.kamal@arifhabibltd.com	+92-2132460717-19 Ext : 211
<b>International sales</b>		<b>Email</b>	<b>Telephone</b>
Mohammed Imran	Head of International sales	m.imran@arifhabibltd.com	+92-21-3246-2598
<b>Domestic sales</b>		<b>Email</b>	<b>Telephone</b>
Sajid Q. A. Bhanji	Vice President and Director	sajid.bhanji@arifhabibltd.com	+92-21-3244-6254
M. Yousuf Ahmed	Senior Vice President	yousuf.ahmed@arifhabibltd.com	+92-21-3242-7050
Farhan Mansoori	Vice President	farhan.mansoori@arifhabibltd.com	+92-21-3247--3268
Syed Farhan Karim	Vice President	farhan.karim@arifhabibltd.com	+92-21-3244-6255
Afshan Aamir	Vice President	afshan.aamir@arifhabibltd.com	+92-21-3244-6256
Furqan Aslam	AVP	furqan.aslam@arifhabibltd.com	+92-21-3244-6256
<b>Corporate finance and advisory</b>		<b>Email</b>	<b>Telephone</b>
M. Rafique Bhundi	Vice President	rafique.bhundi@arifhabibltd.com	+92-21-3246-0741
Kashif Suhail	Vice President	kashif.suhail@arifhabib.com.pk	+92-21-3246-2597
Saifuddin Shamsi	Senior Analyst	saif.shamsi@arifhabibltd.com	+92-21-3246-0741
Kamran Vohra	Senior Analyst	kamran.vohra@arifhabibltd.com	+92-21-3246-2597
<b>Information Technology</b>		<b>Email</b>	<b>Telephone</b>
Amir Saifi	Head of IT	amir.saifi@arifhabibltd.com	Ext: 207
<b>Management</b>		<b>Email</b>	<b>Telephone</b>
Bilal A Moti	CEO	bilalmoti@arifhabibltd.com	+92-21-32460717-9